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Preparing for California's Climate Reporting Legislation: Takeaways and Early Reporting Trends

By Aaron Briggs, Elizabeth Ising, Cynthia Mabry, Michael Murphy, Lauren Assaf-Holmes, and Meghan Sherley

This article summarizes key takeaways and considerations from this year's developments, including the trends from our review of nearly 100 companies' public AB 1305 reports.

Last year, California adopted a trio of laws requiring certain public and private companies to provide climate-related disclosures. As a quick refresher:

- **Climate Corporate Data Accountability Act (Senate Bill 253).** For U.S. companies doing business in California with annual revenues over $1 billion, Senate Bill (SB) 253 requires them to report their greenhouse gas (GHG) emissions annually beginning in 2026 (for Scope 1 and 2 GHG emissions) and 2027 (for Scope 3 emissions).

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- **Greenhouse Gases: Climate-related Financial Risk (Senate Bill 261).** For U.S. companies doing business in California with annual revenues over $500 million, SB 261 effectively requires them to begin biennial reporting in 2025 regarding their "climate-related financial risks" and adopted measures to reduce or adapt to them.

- **Voluntary Carbon Market Disclosures (Assembly Bill 1305).** For companies that make certain environmental claims, adopt particular environmental goals, or purchase, use, market, or sell voluntary carbon offsets in California, Assembly Bill (AB) 1305 requires annual website disclosure providing support for those claims, goals, or offsets.

The California Legislature and Governor Gavin Newsom proposed varied amendments to these laws in 2024, and certain largely administrative amendments have now been signed into law. Litigation challenging SB 253 and 261 is also ongoing, though the laws have not been stayed while the litigation proceeds. As a result, companies are now facing a mostly unchanged—though uncertain—reporting landscape in the state.

To help companies prepare for reporting under these laws (including SB 253 and SB 261, if they ultimately go into effect), we have summarized below our key takeaways and considerations from this year's developments, including the trends from our review of nearly 100 companies' public AB 1305 reports.

SB 253 & 261: Amendments Adopted (But Little Changed For Reporting Companies)

In June 2024, Governor Newsom proposed a trailer bill that would have delayed the initial reporting deadlines for SB 253 and 261 by two years, from 2026 to 2028, and provided the California Air Resources Board (CARB) more time to adopt implementing regulations (delaying the deadline from January 1, 2025, to January 1, 2027), among other changes. These proposals echoed the Governor's previously expressed concerns over the bills' financial impacts on covered companies and timing of the original reporting deadlines.

The California Legislature did not adopt the trailer bill and, rejecting any reporting delay for companies, instead proposed its own amendments (SB 219), which the Governor signed into law on September 27. SB 219 did not remove the SB 253 or 261 filing fee payments, but did remove the requirement that the payments be made at the time the reports are disclosed or submitted. It also makes clear that companies can report at the parent level on a consolidated basis for both reports (this was previously clear only for SB 261 reporting).

The remainder of SB 219's changes impact CARB, including:

- *For SB 253:*

  - extending CARB's deadline to adopt implementing regulations by six months from January 1, 2025, to July 1, 2025;

  - removing the requirement that CARB engage an "emissions reporting organization" to receive companies' GHG emission reports and to develop a digital platform for receiving and disclosing emissions reports, among other responsibilities. Instead, CARB could opt to receive the disclosure directly and develop such a platform;

  - granting CARB greater discretion to set a schedule for Scope 3 GHG emissions reporting, rather than requiring that the deadline be no later than 180 days after Scope 1 and 2 GHG emissions are disclosed;

  - removing the requirement that CARB review and assess GHG accounting and reporting standards every five years after 2033; and

  - extending CARB's deadline to publish the emissions reports it receives from 30 days to 90 days.

- *For SB 261:*
  - removing the requirement that CARB contract with a climate reporting organization for certain activities or publications on the climate-related risks that have been reported.

With Additional Guidance Almost A Year Away, What Can Reporting Companies Do Now

Although the fate of SB 253 and 261 is unclear given the pending litigation, companies can consider the following steps, as appropriate depending on their circumstances, as they prepare for potential SB 253 and 261 reporting:

- **Consulting with counsel** to determine whether they would be required to report under SB 253 or 261. Where companies' current revenue levels or activities do not meet the thresholds, but are very close, **monitor acquisition activity and any anticipated increases in revenue** that may push the company into scope in future years;

- **If there is no current emissions reporting process**, consulting with internal stakeholders and external advisors to estimate the time for developing such a process;

- **If there is a current emissions reporting process, review the current process and controls** to assess differences between the company's current methodology and the Greenhouse Gas Protocol and what updates may need to be made;

- **Reviewing the time required to obtain limited assurance** on Scope 1 and 2 GHG emissions data. If limited assurance is not currently being obtained, conduct a gap analysis to determine what additional work may be required to obtain it and identify potential third-party firms who could provide assurance;

- **Conducting a gap analysis** of any current climate-related risk reporting against the reporting standards referenced in SB 261—the Task Force on Climate-related Financial Disclosure (TCFD) or International Sustainability Standards Board (ISSB) standards—including reports currently described as TCFD or ISSB reports. Such reports have historically been voluntary, and additional disclosure may be required now that the disclosures are being prepared for legal compliance purposes; and

- **Revisiting environmental policies and voluntary sustainability reporting**. Companies may currently describe climate-related issues in different documents prepared by different teams for different purposes, such as committee charters, environmental policies, CDP questionnaire responses, and proxy statement or other public or regulatory reporting. In advance of potential mandatory reporting, consideration should be given to aligning these teams and internal controls.

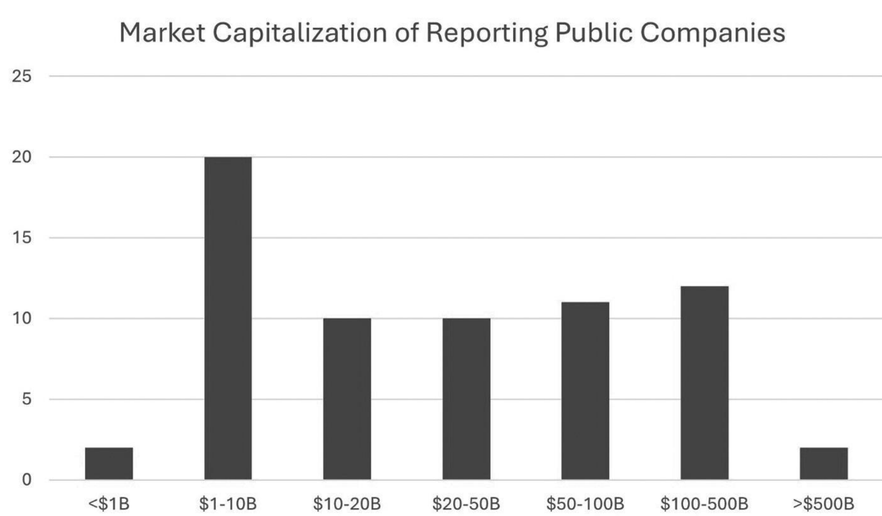
AB 1305: No Pending Changes, But A Wealth of Examples

AB 1305 does not specify the first reporting deadline for required disclosures: instead, it requires that the disclosures be updated no less than annually. The resulting uncertainty as to whether the first reporting deadline would be January 1, 2024—when the law first became effective—or January 1, 2025, resulted in some companies providing responsive disclosures late in 2023 and early 2024. To address this question, in January 2024, the author of AB 1305 published a statement of legislative intent reflecting his expectation that the first responsive disclosures be posted by January 1, 2025.

The California Legislature then progressed on a number of amendments to AB 1305 through AB 2331, including to push the first reporting deadline further (to July 1, 2025), carve out certain renewable energy credits (RECs) from the definition of voluntary carbon offsets, and substantively revise the information required under the law, particularly for the marketing or sale of voluntary carbon offsets. AB 2331 was not passed by the California Legislature prior to the close of the general session in August, leaving the original reporting requirements in place for now. However, the California Attorney General has issued a formal legal opinion concluding that RECs used by reporting companies outside of California's regulatory programs would not be considered voluntary carbon offsets for purposes of AB 1305.

Early Filers Provide a Range of Reporting Approaches. AB 1305 does not contain specific formatting or presentation requirements. This is a notable contrast to other more prescriptive California website reporting requirements and has resulted in a variety of approaches to AB 1305-related reporting across the more than 90 reports that have been published as of early September 2024. Key takeaways from our review of these reports include:

- **Most Filers are Public Companies.** We identified at least 68 public company reports and 26 private company reports across a range of industries. As one public company subsequently took down their report, we have excluded it from the following statistics, for a total sample of 93 companies. Below, we have summarized the market capitalization for reporting public companies.
- **Most Acknowledge a Sample or Category of Potentially In-Scope Claims.** Most companies (70, or 75%) provided some reference to potential in-scope claims they had made, whether it was noting a specific achievement or corporate goal (e.g., achieving carbon neutral operations or adopting a net zero goal) or making a generic reference to its past reporting on targets and emissions reductions.
- **Few Companies Provide an Explicit Tie to Each Requirement**. Only 12 companies (13%) provided an index or heading identifying their claims or supporting information side by side with each reporting requirement.
- **Most Do Not Summarize AB 1305's Requirements.** More than three-quarters of the companies surveyed (72, or 77%) did not include a description of AB 1305's reporting requirements, while the remaining 21 companies (23%) provided a full or partial description.
- **Most Do Not Include an "As Of" Date or Disclaimer.** Less than half of companies (37, or 40%) included a clear "as of" date for the disclosure, which must be updated no less than annually. Twenty-seven companies (or 29%) included a general disclaimer regarding



the report's contents and/or a more extensive forward-looking-statement-type disclaimer.

- **Most Disclosures Focus Only on Applicable Requirements.** Only a quarter of companies (23, or 25%) included an affirmative statement that some portion of the law did not apply to them (e.g., that they did not purchase or use voluntary carbon offsets). Otherwise, companies typically were silent on this but addressed only the sections of the law that were applicable to them: in other words, if they only market or sell voluntary carbon offsets, they only addressed the disclosures required for that activity.

- **Most Prefer a Standalone PDF Format.** Over half of the companies (53, or 57%) provided their AB 1305 disclosure in a standalone PDF available on their website. A smaller portion (28, or 30%) provided the disclosure on their websites as a standalone webpage, while 11 companies (or 12%) addressed AB 1305 as a subset or reference on an existing page. In one instance, the disclosure was available only by clicking an "AB 1305" link on the website that downloaded an Excel file.

Considerations for Preparing (or Updating) AB 1305 Disclosures

In addition to the reporting trends noted above, reporting companies preparing or updating their AB 1305 disclosures should also consider:

- **Reviewing current website disclosure and corporate publications** to identify relevant claims and **conducting a gap analysis** between AB 1305's requirements and current public disclosure. The results of our survey only reflect those public disclosures that were clearly identified as being provided for purposes of AB 1305 and may not represent the full universe of disclosure approaches. For example, some companies may already provide the responsive disclosure in existing reports and determine a standalone report or heading is not necessary;

- **Building out internal controls and resources** to collect relevant claims, activities, and corresponding support throughout the year;

- **Educating relevant stakeholders** that will be important to support the identification of claims or activities, including the marketing, sales, product, procurement, and investor relations teams. For example, AB 1305 can apply to claims about the company's products, and such claims can appear in locations that the legal or compliance teams are less involved with, such as advertisements, mailings, press releases, or product literature that can reach California consumers. The relevant internal controls may therefore run through the legal or compliance teams, but will likely rely in part on information from other areas of the business; and

- **Monitoring for future developments**, because while changes proposed by AB 2331 were not ultimately adopted this year, similar changes may be sought in future legislative sessions.

Ceres Guidance for Engagements with Directors on Climate Risk Governance

By Rob Berridge and Jay Zubillaga

Climate change poses material risks to individual companies and systemic risks to investors' portfolios.[1] The extent of these risks, and that there is no avenue for investors to diversify away from them, means that reliable and comparable public disclosure is needed by investors to properly evaluate and understand the value of a company's business. Information about the systems and processes that companies have in place at the board and senior management levels to oversee climate-related risks and opportunities, otherwise referred to as climate risk governance, is a core component of the public disclosure needed by investors. Such governance determines how a company's board oversees management's approach to climate-related risks and opportunities and the company's plans for transitioning to operate in a net zero emissions economy.

Regulators in the U.S. and abroad have started to address these risks, with mandatory disclosures on the horizon.[2] Nearly all regulatory frameworks include baseline voluntary disclosure standards such as the Task Force on Climate-related Financial Disclosure (TCFD)[3] and the International Sustainability Standard Board's (ISSB) IFRS S1 and IFRS S2 standards for sustainability and climate-related disclosures. As reporting obligations are finalized in numerous countries, many investors continue to rely on widely accepted voluntary disclosure frameworks and company benchmarking tools, such as the Climate Action 100+ Net Zero Company Benchmark[4], to evaluate corporate climate risk governance as part of their investment decision-making and stewardship activities.

The Ceres guidance, which builds upon these disclosure frameworks and expected regulations, serves as a resource for investors in their company engagements with independent directors. Companies may also want to use this guidance to prepare for stakeholder engagements and to help inform their public disclosures and practices to align with the direction in which all U.S. public companies should be moving on their respective journeys to address the net zero transition.

- This guidance includes steps that investors have typically considered when engagements

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with directors of their portfolio companies do not progress in a meaningful way.

- The Appendix includes a list of sample questions that investors may want to consider when engaging with directors on climate-related issues. These questions are based on the roles and responsibilities of the board of directors, which are distinct from those of management.

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A. Effective Board Oversight of Climate-Related Risks and Opportunities, Greenhouse Gas Emissions Reduction Targets, and Climate Transition Action Plans

Companies should disclose independent board oversight of their climate-related risks and opportunities, including how the company has integrated these risks and opportunities into its strategy and operations.

Disclosures should include how the board or a designated committee oversees the development, implementation, and disclosure of a comprehensive, forward-looking climate transition action plan that relies on science-based greenhouse gas (GHG) emission reduction targets for its scope 1, 2, and 3 emissions, as well as how the board monitors the company's annual progress towards meeting its short-, medium- and long-term targets. In disclosing how it monitors the company's progress, a description of whether and how climate-related considerations or performance metrics are factored into the development of executive remuneration plans should be provided.

Investors generally expect that a company's climate transition action plan will detail how it plans to meet science-based GHG emissions reductions that are aligned with the goals of the Paris Agreement to limit the worst impacts of climate change.

The board's oversight of climate-related risks and opportunities should be clearly reflected in a publicly available governance document on the company's website, such as a board committee charter or – if only at the full board level – corporate governance guidelines. Investors generally expect that, if climate oversight falls under a specific board committee and there are no regulatory requirements mandating that the committee is comprised entirely of independent directors[5], then the board should still form that committee with only independent members.

This is due to the substantial duties involved in supervising climate change-related implications, which span material financial risks and strategic opportunities. Having a fully independent committee provides objectivity and credibility in governing such a critical issue for long-term value preservation and creation.[6]

B. Effective Management Responsibility for Assessing and Managing Climate-Related Risks and Opportunities, Emissions Reduction Targets, and Climate Transition Action Plans

Companies should disclose the existence of an effective cross-functional senior management committee that is responsible for company-wide management of climate-related risks and opportunities, GHG reduction targets, and climate transition action plans. The management committee should generally report to the CEO and disclose its policies and key actions to the full board or the board committee responsible for oversight of climate change-related issues.

The cross-functional senior management committee could include members from the following corporate departments/teams: audit, human resources (including those responsible for executive compensation), investor relations, finance/treasury, marketing, government affairs, legal, operations, product development, strategy, real estate, research & development, risk management, information technology, and supply chain management/procurement.

C. Sufficient Board-level Capabilities and Competencies to Oversee Climate-Related Risks and Opportunities

Companies should disclose sufficient information to reveal the climate competency of their boards. Such disclosure could be in a company's proxy statements or corporate social responsibility (CSR) reports, using disclosures such as board matrices and director biographies that credibly support the experiences and skills listed in the board matrices.

No one director will make a climate-competent board. Rather, a board should assess and be able to explain how the different directors' experiences contribute to the board's oversight of the company's strategy to manage its climate-related risks and opportunities (including, but not limited to, its GHG emissions reduction targets and its climate transition action plan). Boards should consider and disclose how their continuing education helps directors maintain and update the competencies and skills that are necessary to effectively oversee and guide the company's response to its evolving climate-related risks and opportunities.[7]

D. Sufficient Audit Committee Oversight of Climate Risks and Disclosures

Audit committees should be aware of the climate-related reporting requirements the company may be subject to globally, including any related assurance requirements, and should oversee management's preparation for such disclosure requirements.

Audit committees should direct the company's internal audit department and its independent auditors to include in their respective annual work scopes: (1) sufficient testing of the impacts of climate change risk on the company's operations and (2) review of the related disclosures in the company's audited and interim financial statements, including, for example, whether any asset valuation write-downs are appropriate, with clear disclosure of assumptions used in their testing, including the use of base-case and downside climate-related scenarios.

The audit committee should review and discuss with management, the company's internal audit department, and independent auditors the critical audit matters addressed during the audit of the company's financial statements.

Consideration may be given to shifts in demand, technology, and regulations associated with climate change that could impact company accounts, including future cash flows, asset values, asset impairments, and asset retirement obligations.

The final TCFD implementation guidance (page 8) affirms that a company's audit committee should be among those reviewing TCFD disclosures prior to publicly issuing them, regardless of whether the disclosures are in a financial or nonfinancial report.[8] In light of upcoming mandatory climate risk and sustainability disclosure rules, boards should update their committee charters and meeting agendas to reflect the new financial reporting oversight responsibilities that they will have.[9]

E. Sufficient Board and Senior Management Response to Majority-Supported Investor Votes

Investors generally expect boards to take meaningful action in response to majority-supported investor votes (including majority votes against a director's election or re-election), and to do so within a reasonable time after a vote takes place. For shareholder proposals or vote-no director campaigns that receive considerable minority support, often defined as greater than 20% or 30%, investors typically expect the company to disclose its shareholder outreach efforts to understand and address the concerns raised by those supporting votes.[10]

Investor expectations extend to climate-related matters and would apply in cases where:

1. A director failed to receive more than 50% of the votes cast, which was the result, at least in part, of climate-related concerns.

2. A climate-related shareholder proposal received a majority of investor votes cast in any of the company's shareholder meetings over the past three years. The focus of a company's response should be on the RESOLVED clause of the proposal, since that is what shareholders voted on. If shareholders determine that the rigorousness of implementation is questionable, they may refer to the rest of the shareholder proposal to help determine what investors voted FOR.

    - For a shareholder proposal that passed at the most recent shareholders meeting, investors generally expect that the company disclose a plan for timely implementation.

    - For a shareholder proposal that receives a majority of non-insider votes, investors generally expect that the company engage with the proponent of the shareholder proposal and/or its shareholder base and disclose its shareholder outreach efforts in publicly available reports (such as the company's sustainability report or its proxy statement).

    - For a shareholder proposal that receives between 20% and 50% support, investors generally expect that the company disclose its outreach efforts to its shareholder base after the vote and/or the rationale for the degree of company implementation, while taking into consideration the level of support that similar shareholder proposals at the company have received in the past.

F. Sufficient Board and Senior Management Response to Climate-Related Controversies or Failures

Investors generally expect companies to adequately address and disclose the reasons for — along with mitigating actions taken in response to — any material climate-related controversy or failure (including a significant asset write-down related to the controversy or failure) that in the past year has resulted in significant or serial fines or sanctions from regulatory bodies or significant adverse legal judgments or settlements.

G. Sufficient Availability of Independent Directors to Engage with Shareholders on Climate-Related Issues

Company boards should make one or more independent directors available to engage constructively with significant shareholders on financially material climate-related risks and opportunities. The significance of a shareholder or a shareholder group should be determined not only with respect to assets under management but also by other factors, such as a shareholder's recognized leadership on governance and climate-related topics.

H. Effective Governance of Paris Agreement-Aligned Climate Lobbying

Company boards should have explicit oversight, either directly or through board committees, for reviewing company policies and practices to determine whether their companies lobby directly or indirectly (through each of their trade or other associations) for public policies that support the transition to a low-carbon economy consistent with the goals of the Paris Agreement.

If the board or committee determines that the company has lobbied (directly or indirectly) against Paris-aligned policies (or in favor of actions that would delay, negate, or obstruct such policies), it should oversee public disclosure explaining the reasons behind this misalignment, along with any steps the company is taking to address legal, financial, or reputational risks resulting from this misalignment.[11]

I. Sufficient Disclosures Pursuant to the TCFD Recommendations or IFRS S2

Until the mandatory climate-related disclosures are implemented, companies should continue to disclose according to the TCFD recommendations or IFRS S2 standards. If a company's reporting does not fully cover all 11 TCFD recommendations or all the core elements of IFRS S2, the company should disclose its plan for making all the recommended disclosures public within a specified timeframe. Subject to superseding regulations, these disclosures should appear in a company's annual financial reporting, sustainability report, or standalone TCFD report on a company's own website.

J. Board Accountability for Climate-Related Risk Governance

In cases where an investor decides to escalate its engagement with a company on climate-related issues, Ceres notes the following sample board-level engagement tactics and additional steps, as well as mitigating factors, that investors may consider in their engagements with companies regarding their climate-related risk governance.

For investors engaging with companies that they consider have not taken appropriate steps to address financially material climate-related risks and opportunities, this guidance may be used to help inform their engagements with directors who are responsible for overseeing different elements of climate-related risks and opportunities.

Investors have typically considered the following board-level engagement tactics, which may be taken privately or publicly:

Privately, an investor may consider:

- Writing to or meeting with select directors **in advance of** a company's annual shareholders meeting, explaining why an investor may consider a vote against these directors, with reasons tied to the topics that the investor has engaged the company and its independent directors with over the past year(s). The explanation provided by an investor could reference how the company's actions or disclosures have fallen short of the investor's stated proxy voting policies. If there is sufficient time in advance of the annual shareholder meeting, investors can consider inviting further engagement with relevant independent directors in their private letter.
- Writing to or meeting with select directors **either before or after** a company's annual shareholders meeting, letting them know that this is the last meeting at which those directors can be assured of an investor's support for re-election if meaningful progress is not forthcoming on the topics on which the investor has engaged the company and its independent directors over the past year(s).
- Writing to or meeting with select directors **after** a company's annual shareholders meeting, explaining why an investor voted against

these directors, with reasons tied to the topics on which the investor has engaged the company and its independent directors over the past year(s), while inviting further engagement with relevant directors. The investor's explanation could also reference how the company's actions or disclosures have fallen short of the investor's stated proxy voting policies.

Publicly, an investor may consider:

- Publicly pre-declaring their votes against select directors on an investor's website, a third party's website (such as the PRI Proxy Voting Website), or (upon the advice of the investor's own legal counsel) in an exempt solicitation filed with the Securities and Exchange Commission (SEC), with reasons tied to the topics on which the investor has engaged the company and its independent directors over the past year(s).

- Launching a "vote-no" campaign against select directors in a letter to other company shareholders, which (upon the advice of the investor's own legal counsel) may be filed as an exempt solicitation with the SEC, with reasons tied to the topics on which the investor has engaged the company and its independent directors over the past year(s).

- Alerting one or more proxy advisory firms to the investor's public actions, for their consideration in formulating their own annual shareholder meeting recommendations for the company's directors.

- Depending on the vote outcomes for select directors, writing **publicly or privately after** a company's annual shareholders meeting to these directors to ask how they intend to respond to the vote outcomes, as well as to inquire about the feedback the directors have received from other shareholders regarding the reasons behind the negative votes. This direct outreach would allow investors to convey their perspectives, understand the board's planned actions, and assess whether those actions sufficiently address shareholder concerns raised through the vote outcomes.

Investors who have taken board-level escalation steps have often included one or more of the following types of directors in their engagements:

- Chairs of the most relevant board committees.

- All members of the most relevant board committees.

- For situations without specified committee climate oversight responsibility, one or more of the following:

    - o Audit committee chair (or all audit committee members), since audit committees are generally responsible for risk oversight.

    - o Nominating/governance committee chair (or all nominating/governance committee members), since nominating/governance committees are responsible for recommending to the full board the delegation of appropriate board committee oversight of relevant risk issues.

    - o Public affairs/sustainability committee (or equivalent committee) chair (or all committee members), since they may have relevant oversight responsibilities.

    - o Independent chair or lead independent director.

    - o All members of the board of directors.

    - o Directors with problematic or insufficient experience or expertise

In evaluating whether to initiate any escalation steps with one or more directors, investors often consider additional context for individual companies, including the specific industry's pace of decarbonization (as determined by leading groups such as the Science Based Targets initiative and the International Energy Agency's Net Zero by 2050 Roadmap) and related disclosures, geographies, and technological advances. When considering board-level engagement tactics, it is important for investors to identify and prioritize dialogue with directors whose specific backgrounds, committee memberships, and oversight responsibilities are most relevant to the climate risk issues or opportunities being raised. Prioritizing the right directors helps ensure substantive discussion with those accountable for overseeing the specific areas of climate change preparedness that investors find lacking, including enhanced oversight disclosures.

Notes

1. Most investors maintain highly diversified portfolios designed to capture the returns of the overall market. For such investors, climate change poses a systemic risk that could broadly impact economic productivity, resource availability, supply chains, infrastructure, and social stability across sectors and geographies. Since these portfolios are essentially invested in the entire market, widely diversified investors cannot effectively mitigate climate risks through portfolio rebalancing alone. The pervasive and escalating effects of climate change have the potential to disrupt economic systems and markets as a whole, threatening the long-term performance of broadly diversified portfolios. As a result, climate change represents a systemic portfolio risk that could impair returns for investors seeking to replicate overall market performance.

For additional resources on systemic risk management and portfolio materiality, see:

- A Legal Framework for Impact: Sustainability Impact in Investor Decision Making (Freshfields Bruckhaus Deringer, July 2021)
- Managing Climate Risk in the U.S. Financial System (Commodity Futures Trading Commission, September 2020)
- Addressing Climate as a Systemic Risk (Ceres, June 2020)

2. In the U.S., the U.S. Securities and Exchange Commission (SEC) has approved a rule that will require registrants to report on their material climate risks in a manner consistent with the Task Force on Climate Related Financial Disclosure (TCFD) framework, as well as material scope 1 and 2 greenhouse gas (GHG) emissions. Under the final rule, disclosure would begin on a timeline that starts in 2026 based on FY 2025 information for large accelerated filers. Compliance dates are phased in based on the content of the disclosure and the filer status of the registrant, with smaller and more newly public companies reporting at later dates and on less information. The SEC's final rule was set to take effect on May 28, 2024; however, SEC commissioners voluntarily stayed the rule on April 4, 2024, pending completion of litigation proceedings in the U.S. Court of Appeals for the Eighth Circuit.

In the EU, The Corporate Sustainability Reporting Directive (CSRD) will require many large entities based in the EU, including subsidiaries of an estimated 10,000 non-EU companies, to disclose climate and sustainability information as defined by the European Sustainability Reporting Standards (ESRS), including material Scope 1, 2, and 3 GHG emissions. The CSRD employs a unique double materiality test, meaning companies will report not only on how their business is affected by sustainability issues (financial materiality), but also on how their activities impact society and the environment (impact materiality). The CSRD is a more complex sustainability disclosure regime than pure climate disclosure regulations such as the SEC rule.

The EU will require companies to disclose information on dozens of key performance indicators that encompass biodiversity, resource use, pollution, workforce, and other topics. Reporting will start in 2025 (based on FY 2024 information) for EU companies already subject to the Non-Financial Reporting Directive; large subsidiaries of non-EU parent companies (based on revenue, assets, and employee headcount) will be required to report in 2026 based on FY 2025 data.

In addition, to meet their own reporting obligations, EU companies will likely pass CSRD data requirements down to their major non-EU suppliers through contractual terms, questionnaires, and/or engagement. In addition, the EU's Corporate Sustainability Due Diligence Directive (CSDDD) will require certain large EU and non-EU companies that meet employee and net turnover thresholds to address adverse environmental impacts because of their own operations and to implement and disclose a climate change mitigation transition plan.

In Australia, Canada, Brazil, Japan, the United Kingdom and other non-US markets, regulatory bodies have consulted on or are planning to incorporate the International Sustainability Standard Board's (ISSB) sustainability and climate-related reporting standards (IFRS S1 and IFRS S2) into their mandatory corporate disclosure rules. The ISSB IFRS S2 guidelines, which cover the climate-related reporting standards, have incorporated the TCFD framework.

3. The Financial Stability Board's (FSB) TCFD is a widely accepted framework for company reporting of climate-related financial information that was introduced in 2017 (and was a focus of the previous iteration of this Guidance). The TCFD was fully absorbed by the International Financial Reporting Standard (IFRS) Foundation and incorporated into the IFRS Foundation's ISSB Standards which were issued on June 26th, 2023. The IFRS Foundation agreed to take over the responsibility of monitoring company progress on climate-related disclosures starting in 2024.

Accordingly, the Financial Stability Board announced that the work of the TCFD has been fulfilled, and that TCFD has been incorporated into ISSB's IFRS S1 (General Requirements for Disclosure of Sustainability-related Financial Information) and IFRS S2 (Climate-related

Disclosures) disclosure standards. While monitoring of companies' climate-related disclosures has transitioned from the TCFD to the ISSB, the TCFD's recommendations remain an accepted framework that companies can continue utilizing. As individual countries and regulators update their disclosure guidance to reference the ISSB standards, many companies will be expected to align with the new ISSB framework over time. However, reporting that follows the TCFD recommendations will likely still be viewed as providing decision-useful climate information to investors during this transitional period.

4. The Climate Action 100+ Net Zero Company Benchmark assesses the performance of focus companies against the initiative's **three high-level goals**: emissions reduction, governance, and disclosure on and implementation of net zero transition plans. Four sets of company assessments against the Benchmark have been released since March 2021. For further information, *see https://www.climateaction100.org/net-zero-company-benchmark/*.

5. The New York Stock Exchange and Nasdaq require that the audit, compensation, and nominating/governance committees for all listed companies, with some limited exceptions, be composed entirely of independent directors.

6. For additional climate transition action plan resources, see "Ceres' Blueprint for Implementing a Leading Climate Transition Action Plan" at *https://www.ceres.org/resources/reports/blueprint-for-implementing-a-leading-climate-transition-action-plan*.

7. For additional resources, see Ceres' report "Lead From the Top: Building Sustainability Competence on Corporate Boards" at *https://www.ceres.org/resources/reports/lead-from-the-top*.

8. *https://www.fsb.org/wp-content/uploads/P141021-4.pdf*.

9. For additional resources, see the International Federation of Accountants' report: "Key Questions for Audit Committees Overseeing Sustainability-Related Disclosure" at *https://ifacweb.blob.core.windows.net/publicfiles/2023-05/key-questions-audit-committees-sustainability-disclosure.pdf*.

10. See pg. 07 of Ernst & Young's Five Top Takeaways from the 2024 Proxy Season at *https://www.ey.com/content/dam/ey-unified-site/ey-com/en-us/campaigns/board-matters/documents/ey-five-top-takeaways-from-the-2024-proxy-season.pdf*.

11. For additional resources, please refer to the Global Standard on Responsible Corporate Climate Lobbying. The standard was designed to help companies and investors assess and ensure that corporate lobbying efforts support meeting the Paris Agreement goals. Investors and companies may also find the Responsible Policy Engagement Analysis published by Ceres in November 2022, the Responsible Policy Engagement Benchmarking for Banks published by Ceres in August 2023, the Responsible Policy Engagement Benchmark for Power Companies published by Ceres in January 2024, and the Responsible Policy Engagement for Automotive Companies published by Ceres in May 2024, to be useful resources on lobbying and policy influence practices.

SEC Fines Director for Failing to Disclose Close Friendship With Senior Executive

By Thomas Conaghan, Paul Helms, Eric Orsic, and Daniel Woodard

In a novel enforcement action, the US Securities and Exchange Commission (SEC) charged a member of the board of directors of a New-York-Stock-Exchange (NYSE)-listed manufacturer of personal and household products for violating the proxy disclosure rules. According to the SEC, the director stood for election as an "independent" director when he did not qualify as independent due to an undisclosed close friendship with one of the company's high-ranking executives. The director was personally fined $175,000 and barred from serving as an officer or director of a publicly traded company for five years.

This case serves as a reminder of one of the primary roles of directors in a publicly traded company: to oversee and monitor senior management on behalf of the stockholders who elect them. This case also highlights the fact that director independence is highly dependent on facts and circumstances and, although public company boards are required by stock exchange rules to assess board member independence annually, the burden is on the individual board member to disclose to the board (so that the board can make its independence determination) relationships with senior management that impair independence.

In this case, the SEC found that the director not only failed to disclose his personal friendship with the executive, but actively sought to conceal it from the company's Board of Directors in a breach of the director's duty of candor under the company's Code of Conduct. Such breach, in the context of the company's annual proxy statement disclosure exercise, violated Section 14(a) of the Securities Exchange Act of 1934.

Thomas Conaghan, Paul Helms, Eric Orsic, and Daniel Woodard are attorneys of McDermott, Will & Emery LLP.

Background

According to the allegations in the complaint, the individual charged by the SEC was an experienced public company director. After serving as the CEO of the company for 11 years, he served as the non-executive chairman of its Board for four years. He also served as an independent director of two other public companies during the period in question.

In 2019, the Board made the determination that after the required "cooling off" period from his former executive days had transpired (the director retired as CEO in 2015), nothing precluded him from being classified as an "independent" director since he did not otherwise have a material relationship with the company or its senior management team. As a result, the director stood for reelection at the annual stockholders' meetings from 2019 to 2023 and was described as an "independent" director candidate.

However, according to the SEC, the director had a close personal relationship with the executive since 2017. The director and the executive, along with their spouses, regularly vacationed together – both domestically and internationally – from 2020 to 2023, including six trips that spanned eight countries across five continents. During these trips, the director paid for the executive's first-class airfare and lodging. In all, during the relevant period, the director spent more than $100,000 on travel and vacations for the executive and his spouse. The director did not disclose this relationship to the Board and advised the executive not to tell anyone at the company about their close friendship.

In addition to the travel, the director also shared with the executive, in violation of his duty of confidentiality, information about a sensitive CEO search process being conducted by the Board, which included the executive's potential candidacy.

Takeaways

The public company governance ecosystem relies on the independence of board members. With certain exceptions, stock exchange rules mandate that public company boards be comprised of a majority of independent directors and major standing board committees (audit, compensation, and nominating/governance) be independent.

These stock exchange governance requirements are meant to instill confidence in the investing public that management teams are overseen by board members who, in addition to complying with state law fiduciary duties, avoid relationships with management that could impair their objectivity.

The SEC action highlights the importance of evaluating independence from multiple perspectives. Under the NYSE rules, no director qualifies as "independent" unless the board of directors *affirmatively determines* that the director has no material relationship with the listed company.

In the words of the NYSE Listed Company Manual, "it is not possible to anticipate, or explicitly to provide for, all circumstances that might signal potential conflicts of interest, or that might bear on the materiality of a director's relationship to a listed company." The overriding concern, however, is independence *from management*. Any relationship between a director and a member of senior management could potentially impair a board member's impartiality and independence.

The NYSE Listed Company Manual provides some guidance on the types of relationships that should be considered. For example, "material relationships can include commercial, industrial, banking, consulting, legal, accounting, charitable and familial relationships, among others." Notably, "friendship" is not called out expressly in the nonexclusive list. And most company "director and officer questionnaires," which effectively function as the front line of defense in the annual board exercise to determine board member independence, track the NYSE commentary on this point.

In the aftermath of the enforcement action, boards should consider revising their questionnaires to inquire about meaningfully close personal relationships between directors and senior management. Even once a company solicits the information needed to evaluate disclosure decisions, the SEC action raises difficult line-drawing questions.

For instance, would a strong mentoring relationship between a board member and an executive impair independence? Similarly, it is not unusual for directors and executives to maintain some form of social relationship outside the company. Perhaps the SEC's action will be limited to its facts, particularly given the alleged extensive effort of the director to conceal the relationship. A different fact pattern very well could produce a different outcome.

The other significant takeaway is the SEC's decision to pursue an action against the director personally, rather than the issuer, for misleading proxy disclosure. That decision could have been made for any number of reasons (including the active concealment of the relationship by the director), but it signals the SEC's willingness to pursue, penalize, and bar individual board members.

Directors should take note of the SEC's aggressive posture, and public companies should be wary of future cases that might charge the public company alongside or in place of the director. The SEC has been aggressively pursuing public companies for internal control failures to identify information required for public disclosures.

More philosophically, this case also reflects the SEC's willingness to recast stock exchange corporate governance principles as federal securities law disclosure claims.

While individual directors digest this recent SEC enforcement action, it might be prudent for public company legal departments to consider all aspects of the annual board independence process, including the questionnaire forms used, to better assist boards in discharging this important annual duty.

From Expert to Director: How to Navigate the Complexities and Scrutiny of Public Company Board Service

By Era Anagnosti, John Gilluly, Sanjay Shirodkar, Andrew Ledbetter, and Ron Llewellyn

Becoming a first-time director of a public company is a goal not easily achieved and can represent a significant personal and professional accomplishment, giving an individual a platform to share their expertise to help a company attain its strategic objectives.

Although fiduciary duties under state corporate law are well established and not the primary focus of this article, public company directors are encumbered by a multitude of duties and responsibilities mandated by federal securities laws and the regulations of securities exchanges. A new director is expected to navigate ancillary restrictions, heighted scrutiny, and various challenges that can be onerous.

These factors necessitate careful consideration prior to accepting a first-time nomination or appointment to the board of a public company. It is important that you familiarize yourself with the legal implications resulting from your new role as a director, which we summarize in this article.

Disclosure Obligations

Directors must be prepared to share meaningful personal information – and have it scrutinized by the general public, including potentially antagonistic parties. Public companies are required to disclose various information about their directors (including director nominees) in their proxy statements or annual reports on Form 10-K, which are filed with the US Securities and Exchange Commission (SEC). New directors should prepare to deal with the consequences of the following information being disclosed:

- ***Biographical information.*** Companies must describe the business experience of each director for the past five years, including occupation, employer, qualifications and skills, and other public company directorships. To meet this disclosure requirement, companies often solicit such information through a directors' and officers' questionnaire (D&O Questionnaire). In the case of a new director, a company may conduct a background check in addition to relying on the D&O Questionnaire. It is not unusual for this process to reveal discrepancies between a director's biography used in other formats and the background check, so best practice is to address any informational inconsistencies prior to public disclosure.

- ***Compensation.*** Companies must disclose annual compensation paid to directors, including retainers and equity awards, and the aggregate number of stock and option awards outstanding at fiscal year-end (even if awarded in prior years). Compensation deemed as "excessive" for a director may attract unwanted scrutiny from investors, regulators, and other corporate stakeholders.

- ***Family relationships and related party transactions.*** Any family relationship between a director and another director or executive officer of the company must be disclosed. In addition, any transaction involving the company that exceeds $120,000, and in which a director has a direct or indirect material interest, must be reported in the company's SEC filings. This includes, for example, transactions with companies at which the director owns a ten-percent interest or salary paid to immediate family members of the director working at the company.

Era Anagnosti, John Gilluly, Sanjay Shirodkar, Andrew Ledbetter, and Ron Llewellyn are attorneys of DLA Piper LLP.

A director is expected to exercise great care in completing the D&O Questionnaire. Failure to accurately disclose information in the D&O Questionnaire may have a range of negative consequences, from an inaccurate determination of a director's independence status to enforcement actions and civil penalties against the director. The D&O questionnaire can be a lengthy and dense document, and a new director is encouraged to consult with counsel to ensure the accuracy of the information provided in response thereof.

In addition, under Section 16(a) of the Securities Exchange Act of 1934, as amended (the Exchange Act), directors must report ownership of and transactions in the company's stock (*eg*, grants, purchases, sales, or gifts) by timely filing Section 16 reports with the SEC – these reports are publicly available. Section 16 of the Exchange Act is designed for company insiders to return any profits made from the purchase and sale of company stock if both transactions occur within a six-month period (*ie*, a "short-swing" transaction).

Although most companies will file these reports on behalf of directors as an accommodation, a director is expected to promptly report any such transactions to the company to determine whether Section 16 reporting is triggered and, if so, ensure the timely filing of such reports, which in most cases is required within two business days of the transaction. Compliance with Section 16 and lack thereof can be scrutinized by regulators and the plaintiffs' bar and have undesirable consequences, which may be avoided by understanding the fundamental requirements of Section 16 and having a reliable compliance system in place. Public companies are required to report any "delinquent" Section 16 reports in their proxy statements, inviting further unwanted attention to a director.

Furthermore, Section 13(d) of the Exchange Act requires certain holders of more than five percent of a company's equity securities registered under the Exchange Act to file a beneficial ownership statement on Schedule 13D with the SEC.

Generally, a director who becomes subject to Section 13(d) reporting will have to file a Schedule 13D within five business days of exceeding the five-percent ownership threshold and must file an amendment to Schedule 13D within two business days following a material change in the previously reported beneficial ownership. Similar to Section 16 filings, any Schedule 13D filing by a director is likely to attract attention from shareholders, regulators, and other stakeholders.

Other Restrictions

Securities trading

Most public companies have insider trading policies that govern when directors, executive officers, and other insiders can engage in transaction in the company's securities and the procedures for doing so. Such policies help to ensure compliance with Exchange Act Rule 10b-5, which prohibits trading of securities while in possession of material nonpublic information (MNPI) (*ie*, insider trading).

Most notably, companies regularly impose blackout periods that prohibit trading by insiders, typically starting two weeks prior to the end of each fiscal quarter until after the company's quarterly results have been announced and digested by the markets, which is often in the middle of the second month of the next fiscal quarter.

Absent a 10b5-1 trading plan, blackout periods limit directors to only transact in company securities during a few weeks each quarter. Even then, the director may be in possession of MNPI, such as a material acquisition or disposition, financing, share buyback, or change in leadership, that might prohibit the director from transacting in the company's securities.

Most public companies have insider trading policies to prevent trading while in possession of MNPI and to comply with Exchange Act Rule 10b-5. To trade more flexibly and avoid insider trading risk, a director may adopt a written 10b5-1 plan that sets a formula and timing for trading in the company's securities over which the director has no discretion.

Such plans, referred to as "10b5-1 plans," must be entered into (i) when the director is unaware of any MNPI, (ii) in good faith, and (iii) not to evade Rule 10b-5's prohibitions. Such plans can provide an affirmative defense to insider trading charges. The director must inform the company of any 10b5-1 plan or changes to it, and the company must disclose them in its periodic filings. Most insider trading policies require insiders to have their proposed 10b5-1 plans approved by the company prior to entering into them. No transactions can take place under the plan until after a cooling-off period of at least 90 days.

An insider trading policy with preclearance procedures may also prevent the director from violating Section 16(b) of the Exchange Act, which allows a company to disgorge from a director (or other insider) any profits made from short-swing transactions in company securities. Such procedures may require the director to get pre-approval of any trades in the company's securities, even if they are not in possession of MNPI to facilitate the detection of trades that would violate Section 16(b).

Directors, as company affiliates, also face limitations on resales under the Securities Act of 1933, as amended (Securities Act). Unless a registration statement covers the resale of the securities held by directors, such securities may only be sold in compliance with the volume, manner of sale, and current public information requirements under Securities Act Rule 144 (and, if the securities were issued to the director in an unregistered transaction, a six-month holding period). Pre-clearance for such trades will also help to ensure compliance with Rule 144.

MNPI pitfalls

Directors of public companies very often are in possession of a company's MNPI, which raises the risk of inadvertent disclosure, insider trading, violations of Regulation Fair Disclosure (Regulation FD), and indications of compromised internal controls.

Regulation FD of the Exchange Act prohibits a public company from selectively disclosing MNPI to securities market professionals and shareholders unless it makes this information publicly available through Regulation FD-compliant channels. Sometimes a director may be required to engage with investors and such conversations can raise Regulation FD concerns. New directors are encouraged to understand a company's reporting cadence to ensure compliance with quiet periods and trading window restrictions, and to consult with internal or external legal counsel regarding the scope of information to be shared ahead of any events or meetings, such as shareholder engagement meetings.

Stock ownership

Many public companies have stock ownership guidelines for directors. Such policies may require a director to hold a certain amount or percentage of the company's stock and may prohibit them from pledging or hedging the company's stock, curtailing the director's ability to engage in routine risk mitigation or financial planning activities using the company's stock. While such guidelines may help to ensure long-term alignment of interests between directors and shareholders, they can also impact tax planning, portfolio diversification, estate planning, and other personal objectives of the director.

Competitive interlocks

Section 8 of the Clayton Act prohibits an individual from serving as an officer or director of competing companies. A director may need to resign or be restricted from joining another company as a board member or officer if that company is deemed to compete with their current company. In the last few years, both the Federal Trade Commission and the US Department of Justice (DOJ) have prioritized compliance with the Clayton Act, and, in April 2024, the DOJ announced that it is scrutinizing overlapping executives and directors among artificial intelligence companies. A director or director nominee is encouraged to assess whether, based on their current or planned outside activities, appointment would raise Clayton Act concerns.

Additional Scrutiny

In addition to the obligations and restrictions noted above, public company directors are regularly scrutinized by shareholders, shareholder advisory firms, and other stakeholders, such as when a company is missing earnings guidance, receives less than 70 percent support on say-on-pay vote, or is viewed as having weak corporate governance.

For example, in a proxy contest, an activist investor or dissident shareholder may vote against a director nominee or propose an alternative slate of nominees, and it is not uncommon for activist investors to publish negative information about an incumbent director's background, experience, or personal relationships. The SEC also recently adopted the universal proxy rules that require the inclusion of alternative nominees on the company's proxy card to make easier the selection of directors by shareholders.

Shareholder advisory firms, such as Institutional Shareholder Services (ISS) and Glass Lewis, play a significant role in institutional investor voting. Board expertise, composition, and risk oversight are topics of particular focus for both ISS and Glass Lewis and often lead to comments on a director and their background. A director who is viewed as overcommitted, not sufficiently independent from management, or serving on a board committee that is deemed to be performing inconsistently with the advisory firms' expectations may garner a negative vote recommendation from shareholder advisory firms.

While generally more constrained than activist investor campaigns, proxy advisory firms may widely circulate such negative recommendations, specifically naming the director. A new director should be prepared to withstand the scrutiny and the potentially negative publicity that may arise in such situations.

Directors may face additional scrutiny and liability when approving transactions involving related persons or in which there are actual or perceived conflicts of interests. Such transactions, and the conduct and roles of directors in approving them often is carefully examined, including in litigation.

In evaluating these transactions, Delaware courts have generally applied a stricter standard of review unless, from the beginning, a functioning special committee of independent directors negotiates the transaction, and the transaction is approved by a majority of disinterested shareholders. In some cases, the relationship between the directors who sat on the special committee and the interested party has been closely scrutinized. An individual considering joining a board is encouraged to consider any potential conflicts that may exist or develop and how they should be disclosed and considered in the context of any corporate action.

Adjusting to the Board

A new director will typically participate in an onboarding process that will allow them to understand the board's and the company's distinct culture. In addition to learning about fiduciary duties, board and committee roles, and the company's operations and strategic plans – which are recommended to be part of the onboarding process – a new director is encouraged to build relationships with the other directors to gain greater context and insights into board dynamics and corporate issues and to learn from the experiences, backgrounds, and perspectives of the other directors.

Successful onboarding programs for new directors often involve one-on-one meetings, dinners, and other activities primarily intended to help new directors connect with the other directors. However, if this is not part of the company's program, the new director should consider informally conducting such outreach.

Effective onboarding may also allow a new director to be better prepared to actively participate in board deliberations, including voicing dissent and challenging long-established practices and procedures when appropriate. Although board collegiality is important, a director should communicate and act in a manner they believe to be in the best interests of the company and in accordance with their fiduciary duties. To maintain a constructive board culture, directors should avoid letting disagreements over dissenting views escalate into hostility or damage their collaboration.

It may take time for a new director to learn the most effective way to find their voice within an established board. Strong board leadership can ease the acclimation of new directors by encouraging active participation and soliciting opinions. In turn, a new director is encouraged to understand the board's leadership structure, including its relationship with the company's chief executive officer (CEO) and other senior executives. In instances in which the board chairperson and CEO roles are combined, the new director may look to the lead independent director to ensure that the views of nonexecutive directors are communicated and that the board effectively exercises its oversight responsibilities.

Time Commitment

Public company board service often requires a considerable amount of a director's time – and a person considering board service is encouraged to consider whether they have the capacity to adequately prepare for and perform the role. In moments of crisis or significant developments for the company, the board will generally be asked to meet frequently, and potentially at a moment's notice, to weigh in on critical issues whose outcomes may significantly alter the company and its future.

Meetings are often held in person and may require travel. Directors are encouraged to thoroughly review all materials made available prior to meetings. Such materials may include prior board and board committee minutes, resolutions to be voted on, management reports and proposals, and training materials. Reading these materials in advance may allow the board to have more substantive conversations during the meeting and prepare directors to ask more focused questions during meetings.

In addition, directors are often asked to serve on one or more board committees, which have separate meetings and delegated authorities and responsibilities. Committee activities increase the time commitment and responsibilities of each member, particularly in moments of crisis or during significant developments.

Finally, as noted earlier, shareholder advisory firms may recommend that investors vote against the election of a director who they deem to be "over-boarded" or otherwise too busy to perform the role effectively. For these reasons, directors and nominees are encouraged to give careful thought to the requisite time commitment.

Conclusion

Directors play a crucial role in shaping the strategic direction and providing risk oversight of a public company. While certainly a career highlight for many, being a public company director has legal significance beyond the validation of one's expertise and thought leadership in their industry. A new director is encouraged to understand and be prepared to take on the duties – and the challenges – of board service, helping ensure a successful tenure that will benefit the director, the company, and its shareholders. It all should start with having a better understanding of what public company board service entails and committing oneself to the role's demands.

Director Compensation: Current State is Steady State

By Matt Vnuk, Dan Laddin, and Kyle White

Each year, Compensation Advisory Partners analyzes non-employee director compensation programs among the 100 largest US public companies. These companies are trendsetters and can provide early insights into evolving pay practices across the broader public company marketplace. This report reflects a summary of pay levels and pay practice trends based on the most recent 2024 proxy disclosures.

Key Takeaways

- Median total board compensation was flat year-over-year ($325K)
- Similarly, compensation provided for service in board and committee roles was also flat versus prior year median
- Meeting fees and use of stock options continue to be uncommon, with only 6% of companies paying board meeting fees and only 2% granting stock options to their directors

Looking Ahead

- During the next year, we expect a modest increase to median pay levels for standard board service.
- We also expect to see continued focus on the additional retainers provided to Lead Directors and Committee Chairs.

Matt Vnuk is a Partner, Dan Laddin is a Founding Partner, and Kyle White is an Associate at Compensation Advisory Partners.

CAP Findings

Board Compensation

- *Total Fees*. Median board compensation was $325K, which was flat year-over-year. At both the 25th and 75th percentiles, board compensation increased +2%, to $305K and $348K, respectively.
- *Pay Structure*. Companies rely mainly on annual retainers (cash and equity) to compensate directors. Pay programs for large companies are simple and tend to not use meeting fees. Only 6% of the companies in our sample continue to have meeting fees.

  Almost half of these companies only pay meeting fees when the number of meetings exceed a certain threshold. We support this approach as it simplifies administration and the need to define what counts as a meeting, though it may not be appropriate in all situations. All three companies that do provide board meeting fees have non-standard ownership.
- *Equity*. Consistent with prior years, providing full-value equity awards (shares/units) is the standard, with only two companies providing stock options (one of these companies grants both stock options and RSUs). Almost all companies denominated equity awards using a fixed value, not a fixed number of shares. Using fixed value is generally considered best practice as it manages the “target” value awarded each year. This is consistent with practices observed in other recent years.
- *Pay Mix*. On average, total pay was comprised of 63% equity and 37% cash.
- *Form of Increase*. 18% of companies disclosed increases to their annual cash or equity retainers:

- 1% disclosed increases to only board cash retainer

- 8% disclosed increases to only annual equity grant

- 9% disclosed increases to both cash and equity retainers

Committee Meeting[1] Compensation

- *Overall Prevalence*. 35% of companies paid committee-specific member fees for Audit Committee service, while only about a quarter of companies paid fees for service as a member on other committees. Companies rely more on board-level compensation to recognize committee member (non-Chair) service, with the general expectation that all independent directors actively contribute to committees.

- *Total Fees*. Of the companies that paid committee member compensation, the median for additional compensation remained flat for the Audit ($15K), Compensation ($15K), and Nominating/Governance ($12.5K) Committees.

Committee Chair[2] Compensation

- *Overall Prevalence*. 95% of companies in the study provided additional compensation to committee Chairs to recognize additional time requirements, responsibilities, and shareholder scrutiny of governance.

- *Fees*. Similar to committee member compensation, median additional compensation for Chair service was flat year-over-year for each of the Audit ($30K), Compensation ($25K), and Nominating/Governance ($20K) Chair roles.

Committee Meetings

- Audit Committees are meeting more than two times per quarter.

- At median, Audit Committees met the most with 9 meetings, while Compensation Committees met 6 times and Nominating & Governance Committees meeting 5 times.

Independent Board Leader Compensation

- *Non-Exec Chair*. Additional compensation was provided by 90% of companies with this role. Median additional compensation provided for service in this role was $200K, which was consistent with prior year. As a multiple of total Board Compensation, total Board Chair pay was 1.67x that of a standard Board member, at median.

- *Lead Director*. Additional compensation was provided by 88% of companies with this role. Median additional compensation was flat versus prior year, though we do anticipate increases in the future. At the 25th and 75th percentiles, additional pay provided for this role increased +3% and +5%, respectively.

  Median additional compensation provided for this role is approximately 67% greater than that provided for the Audit Committee Chair role. As a multiple of total Board Compensation, total Lead Director pay was 1.15x that provided to a standard Board member, at median. The difference in pay versus Board Chairs is in line with typical differences in responsibilities.

Pay Limits

- 75 percent of companies have a shareholder-approved limit in place for director compensation, consistent with prior year. Prevalence of limits that apply to both cash and equity-based compensation (i.e., total director pay) is slight majority practice.

- Director pay limits are in place largely due to advancement of litigation where the issue has been that directors approve their own annual compensation and are therefore deemed to be inherently conflicted.

- Similar to last year, limits typically range from \$600K to \$1M, with a median approximately \$800K.

- The limits are generally much higher than annual equity grants and/or total annual compensation. For example, roughly one-third of limits are equivalent to more than 5x the annual equity grants, which (as mentioned above) represents 63% of total annual board pay, on average.

Limit Multiple Range	Prevalence
<= 3x annual equity	32%
3.01x – 5x annual equity	35%
5.01x – 7x annual equity	16%
>7x annual equity	17%

- Companies do not typically change, or review, director compensation limits on an annual basis. They typically review these limits about every three to five years when they look for shareholder approval for a new or amended equity incentive plan/reserve. Only two companies in our sample made changes to their limits over the past year:
  - o Caterpillar increased their equity & cash limit to \$1.0M from \$750K.
  - o MetLife changed their limit to now cover both equity & cash, from equity only, and reduced the limit value to \$1.0M, from \$2.0M.

- Some companies exclude initial at-election equity awards, committee Chair pay, and/or additional pay for Board leadership roles from the limit, but such a practice is the exception not the norm.

- The higher limits above are intended to address situations like having to pay higher amounts to a non-executive Chair. In terms of potential perceived conflict of interest when it comes to setting pay for a non-executive Chair, the incumbent can be recused from discussions and the vote on their own pay.

Equity Retention

- 90% of companies in our sample have a minimum stock ownership guideline in place for outside board members, consistent with prior year. Among these companies, 87% use a "multiple of retainer" approach (e.g., 5.0x the annual cash retainer must be achieved within five years).

- Nearly 40% of companies have a holding requirement where (net-after tax) a portion or all of vested equity awards must be held until a director achieves the minimum stock ownership guideline.

- It is minority practice to require for equity awards to be settled at or after termination of board service.

Some Changes CAP Suggests Companies Consider

- *Communication and Education*: Not all companies get this aspect of effective compensation programs right. Oftentimes, distributing a simple summary (or "cheat sheet") of the director pay program to participants can be an effective tool that limits misunderstandings, help prompt questions, and support consistent understanding of the program, philosophy and rationale behind the program.

- *Recruiting New Directors*. As boards look to refresh and diversify their membership, this may be the time to re-visit initial at-election equity awards for new directors. At-election grants can be a way to differentiate your company's pay program in the recruiting process without a more costly increase to standard director pay levels and more quickly “ramp” the ownership position of new board members.

- *Board Leadership Roles*. Taking on the role of non-executive Chair, Lead Director or Chair of a major Board committee can come with considerable additional time requirements, responsibilities, and reputational risk, yet additional compensation provided for most of these roles only reflects a modest premium on the standard director pay program.

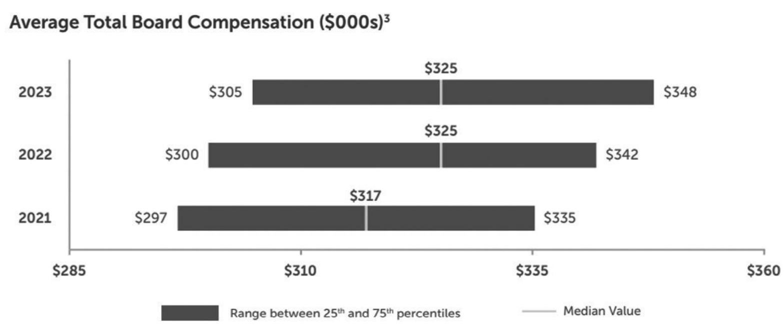
  Providing greater additional compensation for the role of Lead Director of Chair of a major Board committee should be considered, to better align with the typical time requirements, responsibilities, and reputational risk individuals that these roles require.

- *Stock Ownership Requirements*. Especially among the largest companies, it is common practice to require settlement of equity-based pay be deferred until a director leaves the board.

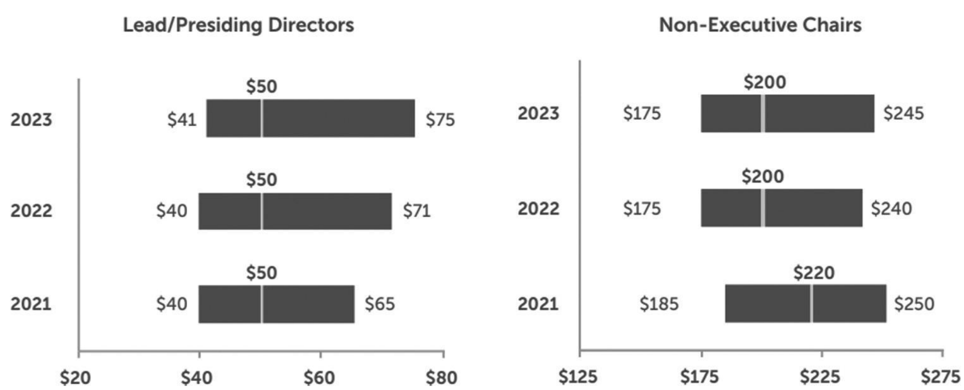
  We support alignment of director and shareholder interests through equity compensation, but allowing access to some equity-based compensation while an active director in combination with a standard stock ownership guideline (e.g., multiple of annual cash retainer) may be a competitive advantage when recruiting new directors who may be more focused on current compensation.

Historical 3-Year Look

Average Total Board Compensation ($000s)[3]



Lead/Presiding Directors – Additional Compensation ($000s)



Notes

1. Audit, Compensation and/or Nominating/Governance Committees.

2. Excludes controlled companies. Also excludes instances where Lead Director role is assumed by Chair of Nominating and Governance Committee, who receives compensation for the role.

3. Total Board Compensation reflects all cash and equity compensation for Board and committee service, excluding compensation for leadership roles such as Committee Chair, Lead/Presiding Director, or non-executive Board Chair.

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